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BRIEF

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IN THE

Supreme Court of the United States

IMPRESSION PRODUCTS, INC.,

Petitioner,

v.

LEXMARK INTERNATIONAL, INC.,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

BRIEF OF PUBLIC KNOWLEDGE, THE ELECTRONIC FRONTIER FOUNDATION, AARP, AARP FOUNDATION, MOZILLA, AND THE R STREET INSTITUTE AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICI CURIAE*

Amici curiae[1] are organizations that advocate for balanced intellectual property law that preserves the rights of the public. The present case relates specifically to consumer rights in ownership of property, and each organization has a strong interest in the correct development of patent law in this area.

Public Knowledge is a non-profit organization dedicated to preserving the openness of the Internet and the public's access to knowledge, promoting creativity through balanced intellectual property rights, and upholding and protecting the rights of consumers to use innovative technology lawfully. As part of this mission, Public Knowledge advocates on behalf of the public interest for a balanced patent system, particularly with respect to new, emerging technologies.

The Electronic Frontier Foundation is a non-profit civil liberties organization that has worked for more than 25 years to protect consumer interests, innovation, and free expression in the digital world. EFF and its more than 33,000 dues-paying members have a strong interest in helping the courts and policy-makers strike the appropriate balance between intellectual property and the public interest.

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[1]Pursuant to Supreme Court Rule 37.3(a), all parties received appropriate notice of the filing of this brief. Petitioner consented to the filing of this brief; Respondent provided blanket consent. Pursuant to Rule 37.6, no counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of the brief. No person or entity, other than *amici*, their members, or their counsel, made a monetary contribution to the preparation or submission of this brief.

AARP is a non-profit, nonpartisan organization dedicated to fulfilling the needs and representing the interests of people age fifty and older. Among other things, AARP advocates for access to affordable healthcare and for lowering costs without compromising quality. AARP's charitable affiliate, AARP Foundation, creates and advances effective solutions that help low-income individuals fifty and older secure the essentials. Given the high cost of prescription drugs in the United States, AARP supports policy that would allow the importation of safe prescription drugs from licensed pharmacies and wholesalers operating in Canada.

Mozilla is a software and technology company, dedicated to ensuring the Internet remains a global public resource available to all. As a wholly-owned subsidiary of a non-profit, Mozilla's work is guided by a set of principles that recognizes, among other things, the importance of interoperability, innovation, and decentralized participation to the Internet. Mozilla works with a worldwide community to create open source products like the web browser Firefox, used by an estimated half billion people worldwide. Mozilla also actively collaborates with other organizations around the world to develop core technology and interoperability standards that power the Internet and the World Wide Web.

The R Street Institute is a non-profit, non-partisan public-policy research organization. R Street's mission is to engage in policy research and educational outreach that promotes free markets, as well as limited yet effective government, including properly calibrated legal and regulatory frameworks that support Internet economic growth and individual liberty. R Street's particular focus on Internet law and policy is one of offering research

and analysis that show the advantages of a more market-oriented society and of more effective, more efficient laws and regulations that protect freedom of expression and privacy.

INTRODUCTION

The many briefs in this case expound upon the effects of the patent exhaustion doctrine on various companies and groups. But there is one constituency that correctly claims the mantle of being the true beneficiary of that doctrine: American consumers and buyers of goods.

Patent exhaustion provides that "the initial authorized sale of a patented item terminates all patent rights to that item." *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625 (2008). By terminating "all patent rights" upon sale, the doctrine ensures that consumers may be secure in their expectations of the incidents of ownership, that they may use and alienate their possessions without fear of the dead hand of control of an upstream seller.

Property ownership is among the most cherished and jealously guarded tenets of American law, and exhaustion guarantees the continued vitality of ownership of physical property. Yet in the present case, the Court of Appeals affirmed two exceptions to the doctrine of patent exhaustion. Specifically, the court held that a "conditional sale" and a sale outside the United States would avoid application of the exhaustion doctrine.

These exceptions, both of the appellate court's own invention, fundamentally undermine those traditional consumer expectations of ownership. Adherence both to the long tradition of the common law and to the policies favoring ownership and alienability of property require that the Federal Circuit be reversed and a patent exhaustion doctrine free of qualifications be maintained.

1. The long pedigree of the exhaustion doctrine points to its focus on protecting consumer expectations in property ownership. Exhaustion springs from a tradition

of common law dating back to the 13th century, a tradition that disfavors restraints on alienation and other post-sale restraints attached to transfers of property. Disapproval of such restraints across those seven hundred years is expressed by noted commentators like Sir Edward Coke and Chancellor Kent and in leading English and American cases. Those commentators and cases consistently justify disapproval of post-sale restraints on the policy of protecting buyers, avoiding confusion in rights of property, and simplifying marketplace transactions in property.

Patent exhaustion effectuates that common law tradition and that consumer protection policy. Exhaustion ensures that a seller may not use patent law to impose the sorts of post-sale restraints that the common law prohibits, and it prevents federal patent law from stepping on the statutory domain of property law long reserved to the states. But by admitting exceptions to the exhaustion doctrine, the Federal Circuit allows patent law to overrun that statutory domain, sidestep the common law, and undermine the consumer protection interest in property ownership. Such a change to centuries of law and policy cannot be sustained.

2. The significance of the Federal Circuit's error is highlighted more brightly by present examples of vendors of products using legal devices such as exceptions to patent exhaustion to impose restraints on consumers' physical devices. Those restraints are serious impediments to consumer choice, free markets, competition, and individual liberty and autonomy.

The ordinary incidents of property ownership are critical to ensuring competitive markets and consumer rights. Secondary markets in goods permit efficient maxi-

mization of value, prevent price discrimination, and avoid waste by enabling reuse and recycling. Full ownership rights also include a right to repair, which opens up a valuable marketplace for repair services.

But ownership rights do not merely have economic value; they are essential to fundamental rights such as speech, autonomy, and privacy. Central to ownership are rights to understand, analyze, and innovate upon one's possessions. These rights take on special importance in an age where personal devices are increasingly complex and computer-driven, and yet whose inner workings are increasingly shielded from consumers' view. Reverse-engineering and tinkering are necessary to uncover flaws and vulnerabilities in complicated devices, to protect users of those devices from undesired behavior such as spying, and simply to make devices work with others.

These practical effects are unsurprising: Product sellers certainly have strong incentives to limit consumer choice and to manipulate markets in those sellers' favor. But law and policy are designed to favor the public—the interests of consumers—and not the whims of sellers. That sellers can and will undertake practices harmful to the consumer interest provides stronger reason for bolstering patent exhaustion, a doctrine designed to protect consumers and property owners.

3. Proponents of a weak patent exhaustion regime offer various reasons why that regime would be preferable, but upon inspection those reasons do not overcome the strong and longstanding interest in protecting consumers' ownership rights.

First, certain parties (notably the pharmaceutical industry) contend that weak exhaustion enables price discrimination that has desirable policy effects (such as

lower drug prices in developing nations). To the extent that these contentions are credible, those desirable policy effects ought to be brought about not by patent exhaustion but by the legislative process. General exhaustion law is the wrong tool for implementing specific goals like drug pricing schemes, and it wrongly puts the decisionmaking process on complex policy questions into the hands of private interests rather than public representatives.

Second, patent owners suggest that it is their right as intellectual property owners to subdivide and arrange their intellectual property rights however they desire. But that has never been the case in the common law: Even real property may not be subdivided into novel forms and estates. The reason, again, is to avoid the confusion and complexity for property buyers that would result from a proliferation of partial ownership rights.

Patent exhaustion is about consumer protection. It is about protection of property rights of the first order: not intangible intellectual property created by statute, but tangible, physical property recognized in Anglo-American law as far back as medieval times. It is that historic tradition that this Court will preserve, by affirming the continued strength of the exhaustion doctrine, by rejecting exceptions that circumvent that doctrine, and by reversing the Federal Circuit.

ARGUMENT

I. PATENT EXHAUSTION IS CONSUMER PROTECTION OF BASIC PROPERTY RIGHTS

A most basic consumer protection and a most fundamental incident of property ownership is the right to use and resell one's possessions. Exhaustion guarantees that once a patented article is authorizedly sold, "the patentee may not thereafter, by virtue of his patent, control the use or disposition of the article." *United States v. Univis Lens Co.*, 316 U.S. 241, 250 (1942). Thus, exhaustion effectuates ownership rights, ensuring that intellectual property law does not interfere with them.

A. CONSUMER PROTECTION UNDERLIES THE LONGSTANDING COMMON-LAW DISFAVORMENT OF RESTRAINTS ON OWNERSHIP

Unrestricted property ownership protects consumers. When a seller places conditions on property at the time of sale, all future buyers suffer both deprivation of the full bundle of traditional property rights and uncertainty as to what rights remain. In view of that policy of protecting consumers' expectations in property rights, the common law thus disfavors post-sale restraints on property.

Protection of the right to use and alienate property has been a cornerstone of Anglo-American law for centuries. *See Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1363 (2013). Consumer protection appears in the very title of what may be the earliest expression of the disfavoring of restraints on those rights, the 1290 statute *Quia Emptores*—"Because of the Buyers."[2]

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[2]Quia Emptores, 18 Edw. 1, ch. 1 (1290) (Eng.). Specifically, the statute permitted alienation by unconditional assignment, but pro-

The oft-quoted treatise of Sir Edward Coke (variantly styled Lord Coke[3]) explains that such restraints impinge on free commerce: that post-sale restraints are "against Trade and Traffique, and bargaining and contracting between man and man." 1 Edward Coke, *Institutes of the Lawes of England* § 360, at 223b (1628), *available at* URL *supra* p. v; *see also id.* § 334, at 205b ("Conditions [on alienated property] bee not favoured . . . .").

Chancellor Kent similarly wrote that "Conditions subsequent are not favoured in law," because such conditions may "infringe upon the essential enjoyment and independent rights of property, and tend manifestly to public inconvenience." 4 James Kent, *Commentaries on American Law* *129, 131 (4th ed. 1840), *available at* URL *supra* p. vii. Professor Gray more strongly contended that restraints on alienation "are inconsistent with that ready transfer of property which is essential to the well-being of a civilized community, and especially of a commercial republic." John Chipman Gray, *Restraints on the Alienation of Property* § 259, at 244 (2d ed. 1895), *available at* URL *supra* p. vi; *see* Richard E. Manning, *The Development of Restraints on Alienation Since Gray*, 48 Harv. L. Rev. 373, 403 & nn.127–28 (1935) (citing cases in accord). Ownership in fee simple, as these commentators recog-

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hibited "subinfeudation," the practice by which the property owner alienated land but demanded feudal duties from the purchaser. *See generally* Ronald B. Brown, *The Phenomenon of Substitution and the Statute Quia Emptores*, 46 St. Louis U. L.J. 699, 708–11 (2002).

[3]Biographies of Coke generally use the title "Sir," and there is reason to believe that to be the more correct form. *See, e.g.*, Cuthbert William Johnson, *The Life of Sir Edward Coke* (2d ed. 1845), *available at* URL *supra* p. vii. This is because "Lord" is a courtesy title for English judges, used only while the person holds office; Coke's *Institutes* were written after his official tenure.

nized, simplifies the transfer of property, to the benefit of consumers and buyers of that property.[4]

The need to protect buyers' ownership rights has sometimes been expressed in economic terms: A proliferation of conditions and restrictions on use or alienation imposes upon buyers an information asymmetry that complicates information-gathering and understanding of rights. *See, e.g.*, Molly Shaffer Van Houweling, *The New Servitudes*, 96 Geo. L.J. 885, 914–16 (2008). But while this terminology is modern, the principle is not.

The Court of Chancery in 1834 rejected the creation of novel limitations on property ownership, saying that "great detriment would arise and much confusion of rights," because "it would hardly be possible to know what rights the acquisition of any parcel conferred, or what obligations it imposed." *Keppell v. Bailey*, 39 Eng. Rep. 1042, 1049 (Ch. 1834). In accord was (then-Massachusetts) Justice Holmes, who refused to enforce a novel fee-tail-like conveyance that, if obeyed, would "put it out of the power of the owners to give a clear title for generations." *Johnson v. Whiton*, 34 N.E. 542, 542 (Mass. 1893); *see also* Zechariah Chafee, Jr., *The Music Goes Round and Round: Equitable Servitudes and Chattels*, 69 Harv. L. Rev. 1250, 1258 (1956) (enforcement of post-sale restraints might "involve such grave possibilities of annoyance, inconvenience, and useless expenditure of money").

While for real property the common law permits exceptions such as easements and covenants, for personal property the common law is far more strict. Recordation

[4]Certainly, the right to enjoy property is not unbounded; the government can limit property rights. But that is a power reserved to the state, not private sellers. *See* Gray, *supra*, at 11–12 n.1.

of post-sale conditions and the infrequency of transfers of land mean that the information costs of post-sale restraints on realty are somewhat minimized; by contrast, chattels are sold often and without recordation. *See* Van Houweling, *supra*, at 915.

Thus, while a conditional device like a servitude may attach to real property, such a device "will not run with or attach itself to a mere chattel." *John D. Park & Sons Co. v. Hartman*, 153 F. 24, 39 (6th Cir. 1907). Restraints on chattels "have been generally regarded as obnoxious to public policy." *W.H. Hill Co. v. Gray & Worcester*, 127 N.W. 803, 807 (Mich. 1910); *see also Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 404 (1911); *Garst v. Hall & Lyon Co.*, 61 N.E. 219, 219 (Mass. 1901); *Taddy & Co. v. Sterious & Co.*, [1904] 1 Ch. 354, 357–58 (U.K.); Gray, *supra*, § 27.[5]

Granted, modern law does provide a device for imposing conditions on personal property—the security interest—but that device further underscores the concern for protecting consumers' ownership expectations. The Uniform Commercial Code permits security interests to demand "performance of an obligation," U.C.C. § 1-201(b)(35), thereby resembling a post-sale restraint on use of personal property. But that code contains specific exceptions for consumers: A person who buys a good "primarily for personal, family, or household purposes" or a

[5] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 907 (2007), overruled interpretations of *Dr. Miles* applying the earlier case to antitrust law. But *Dr. Miles* was a tortious interference case, not an antitrust case, and its recitations of property law and citations to Sir Edward Coke are still correct in that jurisprudential domain—indeed, *Leegin* conceded that property law "tended to evoke policy concerns extraneous to the question" of antitrust. 551 U.S. at 2714.

"buyer in ordinary course of business" will take the good free of any security interest in many cases. U.C.C. § 9-320(a)–(b). These exceptions only confirm the importance of protecting consumers from post-sale restraints.

The common law's disapproval of restraints on use or alienation of chattels is one with "an impeccable historic pedigree." *Kirtsaeng*, 133 S. Ct. at 1363. Any effort to undercut that disapproval, as the Federal Circuit sought to do here, must be met with close scrutiny from both the common law tradition and the consumer protection policies that underlie that tradition.

B. Patent Exhaustion, Properly Applied, Protects Personal Property Ownership

The doctrine of patent exhaustion is the natural extension of the common law rejection of post-sale restraints—indeed, unqualified exhaustion must exist to effectuate that common law principle and the consumer protection policy from which that principle springs.

This Court's case law developing the exhaustion doctrine has closely associated itself with the rationale of protecting consumers from future transactional uncertainty. *Bloomer v. McQuewan*, one of the earliest cases to adopt a version of patent exhaustion, specifically justified its holding based on the interest of the "numerous class of persons, who have purchased patented articles"—that is, protection of the interests of consumers. 55 U.S. (14 How.) 539, 552 (1852). *Keeler v. Standard Folding Bed Co.* more specifically approved of exhaustion of patent rights because "[t]he inconvenience and annoyance to the public that an opposite conclusion would occasion are too obvious to require illustration." 157 U.S. 659, 667 (1895); *see also Motion Picture Patents Co. v. Universal*

Film Mfg. Co., 243 U.S. 502, 516 (1917) (citing to "the cost, inconvenience and annoyance to the public" of non-exhaustion).

Cases have also connected the exhaustion doctrine to the common law view on post-sale restraints. *Straus v. Victor Talking Machine Co.* refused to enforce a "License Notice" restricting the manner of use of patented machines after sale, on the grounds that those restrictions have "been hateful to the law from Lord Coke's day to ours, because obnoxious to the public interest." 243 U.S. 490, 501 (1917). And cases explicitly trace the highly analogous first sale doctrine of copyright both to its roots in Sir Edward Coke and the common law, and to the underlying interest in protecting consumers and free-market transactions. *See Kirtsaeng*, 133 S. Ct. at 1363; *Lifescan Scot., Ltd. v. Shasta Techs., LLC*, 734 F.3d 1361, 1376–77 (Fed. Cir. 2013) (citing *Kirtsaeng*'s common law analysis as applicable to patent exhaustion).

These cases suggest that patent exhaustion simply implements, for patented goods, the common law rules applicable to all personal property. *See* Samuel F. Ernst, *Why Patent Exhaustion Should Liberate Products (and Not Just People)*, 93 Denv. L. Rev. 899, 919–21 (2016); Ariel Katz et al., *The Interaction of Exhaustion and the General Law*, 102 Va. L. Rev. Online 8, 10–17 (2016). And this is unsurprising: Without the doctrine of exhaustion, patent law would create an avenue to impose post-sale restraints and chattel servitudes so long disfavored. There is no reason to think that patent law operates to discard over seven centuries of common law.[6]

[6]Patent law's preemptive effect has little bearing on the exhaustion doctrine—among other reasons, because patent law defers to state law on matters of ownership. *See* 35 U.S.C. § 261.

Two commentators offer an alternate theory: Rather than simply effectuating the common law, exhaustion removes patent law from the domain of property law, allowing common law and other state law to have primacy in defining property rights of ownership and transfer. *See* John F. Duffy & Richard Hynes, *Statutory Domain and the Commercial Law of Intellectual Property*, 102 Va. L. Rev. 1, 7 (2016). *But see* Katz et al., *supra*, at 10 (disputing this theory).[7] This view also supports the need for strong, unqualified exhaustion of patent rights, as the commentators observe, because allowing for circumventions of exhaustion would again allow patents to tread upon the carefully crafted path of property and ownership law. *See* Duffy & Hynes, *supra*, at 76–77.

In all cases, patent exhaustion serves to protect the consumer interest in the same way that the common law protects buyers of property. By mandating that patented goods be sold without future conditions that bind all successive owners, the exhaustion doctrine allows consumers to purchase goods confidently, without need to investigate chains of title or provenance of the goods. The doctrine consequently allows consumers to use, exploit, repair, and dispose of their goods without a cloud of uncertainty that those activities may unwittingly trigger infringement of a patent.

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[7]Duffy and Hynes contend that the common law did not drive the development of exhaustion doctrine, but this Court's explicit case law belies those commentators' assumption. *See, e.g.*, *Kirtsaeng*, 133 S. Ct. at 1363 (Congress presumed to have "intended to retain the substance of the common law") (quoting *Samantar v. Yousuf*, 560 U.S. 305, 320 n.13 (2010)); *Straus*, 243 U.S. at 501 (referencing Coke's views on restraints on alienation).

C. Reversal on Both Questions Presented Is Necessary to Protect Consumer Expectations

By admitting two wide exceptions to the doctrine of patent exhaustion, the Court of Appeals backpedaled on seven centuries of common law and the policy of protecting the ownership expectations of consumers and buyers of property. Reversal and rejection of both of these exceptions is necessary to restore consistency in the law and to correct policy for the public.

First, the Federal Circuit held that exhaustion may be circumvented by a "conditional sale," in which a product is sold with a condition, the violation of which gives rise to patent infringement. *See Lexmark Int'l, Inc. v. Impression Prods., Inc.*, 816 F.3d 721, 735 (Fed. Cir. 2016) (en banc) (Pet. App. 26a); *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 709 (Fed. Cir. 1992). The device of a conditional sale effectively allows for sellers to impose any sort of chattel servitude, restraint on alienation, or other restriction on enjoyment of the incidents of property ownership.

This conditional sale doctrine effectively abrogates the common law's disapproval of post-sale restraints. It also abrogates consumer expectations: A buyer or user of a good must inquire, first, whether that good is subject to any patent-enforceable conditions; second, whether anyone in the chain of title has violated any of those conditions; and third, what the buyer is allowed to do in view of those conditions. The conditional sale doctrine clouds the title of every single patented article sold.

Second, the Federal Circuit held that an authorized sale outside the United States of a patented article does not exhaust patent rights in the article. *See Lexmark*

Int'l, 816 F.3d at 754 (Pet. App. 64a); *Jazz Photo Corp. v. Int'l Trade Comm'n*, 264 F.3d 1094, 1105 (Fed. Cir. 2001). International non-exhaustion creates the same difficulties for consumers. One who purchases a product from a third party must again follow the chain of title for the product (and even components thereof, which may be separately patented), before the purchaser can be confident that the product was fully authorized for use in the United States.[8]

With these two exceptions to the patent exhaustion doctrine, scholars observe that "the Federal Circuit articulated a radical rewriting of not only patent exhaustion, but the nature of consumer property interests." Aaron Perzanowski & Jason Schultz, *The End of Ownership: Personal Property in the Digital Economy* (2016). These exceptions destroy the expectation that use and enjoyment of one's possessions will not be cut short by the dead hand of a former owner.

To justify this remarkable departure from precedent and the common law, the Federal Circuit relied heavily on the case *General Talking Pictures Corp. v. Western Electric Co.*, which held that when a patent licensee manufactures a patented product in violation of the terms of the license, then the products are unauthorized and thus infringing. *See* 304 U.S. 175, 181–82 (1938). The Federal Circuit reasoned that if conditions may be imposed on a licensee, then conditions may also be imposed on a pur-

[8]The government's position fares no better, because if international exhaustion is a default rule that may be overcome by express intention of the seller, then a purchaser of a patented good must still trace the full chain of title on a good to determine whether anyone in the chain sold the good abroad while expressing reservation of patent rights.

chaser. *See Lexmark Int'l*, 816 F.3d at 744–45 (Pet. App. 44–45a).

But reference to the common law and underlying consumer protection policy reveals the error in that analogy. Patent licenses are not ordinarily assignable to others, so concerns about information gathering, transactional efficiency, and consumer protection will affect the licensee but no one further. *See Troy Iron & Nail Factory v. Corning*, 55 U.S. (14 How.) 193, 216 (1853); *Cincom Sys., Inc. v. Novelis Corp.*, 581 F.3d 431, 436–37 (6th Cir. 2009). By contrast, where a physical object is sold, that object is alienable, so any conditions or restraints placed on the sale of the object will travel with the object, through potentially numerous consumers. The holding of *General Talking Pictures* is applicable only to licensees, and has no bearing on the exhaustion doctrine.[9]

Conditional sales and international non-exhaustion, as circumventions of patent exhaustion, contravene the common law's rejection of post-sale restraints on personal property and the public policy interest in protecting consumers' expectations of property rights. This Court once rejected the view that patent owners "could shield practically any patented item from exhaustion." *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 630 (2008). That view must equally be rejected here.

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[9]Indeed, this Court acknowledged the inapplicability of the holding of *General Talking Pictures* to questions of exhaustion, on subsequent rehearing of that case. *Gen. Talking Pictures Corp. v. W. Elec. Co.*, 305 U.S. 124, 127 (1938) ("We have consequently no occasion to consider what the rights of the parties would have been if the amplifier had been manufactured 'under the patent' and 'had passed into the hands of a purchaser in the ordinary channels of trade.'").

II. Manufacturers Currently Exploit Weak Exhaustion Rules to Harm Consumers

Patent exhaustion and the common law are not mere relics of history, but rather solve real problems of policy that are more important today than ever. Recent examples show that, absent checks like patent exhaustion, sellers of products have sought to expand their control over those products in all manner of anti-consumer ways. This Court should ensure that patent law does not provide a roadmap to legitimize such practices.

The anti-consumer practices that a weak exhaustion doctrine enables fall generally into two categories. First, sellers undercut important personal rights such as expression, autonomy, security, and privacy. Second, sellers seek to monopolize important markets such as the secondary resale market and the market for repair services.

A. Exhaustion Loopholes Enable Sellers to Cut Off Speech, Autonomy, and Privacy Rights

Product sellers seek to use intellectual property rights to restrict—often intentionally—the most basic consumer rights ranging from free speech to personal security. Exceptions to patent exhaustion facilitate these negative practices, and those exceptions should be removed.

Manufacturers and sellers like Lexmark here often require consumers to agree to contracts of adhesion such as "Terms of Use" or "End User License Agreements." These contracts represent a wish list of sellers, and indicate the varied ways that sellers seek to impose post-sale restraints on consumers.

Eliminating critical speech. Some of the most troubling demands in these contracts are terms prohibiting consumers from reviewing or otherwise speaking critically about the purchased product. The maker of the Nest thermostat, for example, does not allow purchasers to "release the results of any performance or functional evaluation of any of the Product Software to any third party without prior written approval."[10] Another company informed a customer that it would repair the customer's broken product only after the customer removed a negative review posted online, pointing to the product's terms of service as justification for the threat.[11]

Indeed, manufacturers' desire to control consumers' speech has been so prevalent and concerning that last December, Congress passed a bill prohibiting some of the most egregious cases of form contracts disallowing product reviews. *See* Consumer Review Freedom Act of 2016, Pub. L. No. 114-258. While that law alleviates a limited class of these situations, the fact remains that comprehensive doctrines like patent exhaustion must exist to protect not only consumers' ordinary ownership rights but also rights to speak freely.

Preventing research to protect privacy and security. Manufacturers also use terms of service to stop consumers from reverse-engineering or otherwise researching and investigating the workings of purchased products. Products like Apple watches, Cisco routers, and Fitbit fitness trackers all come with terms of service that prohibit reverse engineering.[12]

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[10] Amicus Curiae Br. Public Knowledge (Cert. Stage) 1a [hereinafter Pet. Amicus Br.].

[11] *See* Tim Cushing, *Software Company Shows How Not to Handle Negative Review*, Techdirt (Dec. 20, 2016), URL *supra* p. vi.

[12] *See* Pet. Amicus Br., *supra*, at 3a, 5a–6a.

Yet reverse engineering is essential for device owners and consumer protection watchdogs who want to determine whether devices are trustworthy. Reverse engineering has investigated important product safety and consumer rights issues, such as security of insulin pumps, unsolicited data collection by smart TVs, fabrication of car emissions test results, and life-threatening defects in car acceleration.[13] Without doctrines like patent exhaustion to prevent manufacturers from exerting post-sale control over reverse engineering, consumers' privacy and security may be put at risk for years without anyone being the wiser.

Restraining innovation. Innovation is an incremental process, with new ideas building upon existing products and knowledge. *See KSR Int'l Co. v. Teleflex Inc.*, 550 U.S. 398, 427 (2007). Much of this innovation comes from consumers modifying or adapting their products in new and unexpected ways. *See, e.g.*, Eric von Hippel, *Democratizing Innovation* 19–31 (2005) (documenting evidence of consumer creativity); Brief of Public Knowledge et al., *Star Athletica v. Varsity Brands, Inc.*, No. 15-866 (U.S. Feb. 5, 2016), *available at* URL *supra* p. v.

But product manufacturers seek to stifle this very innovation through their terms of service. Some disallow the use of the purchased product in conjunction with non-approved software or hardware, such as third-party

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[13] *See* Tammy Leitner & Lisa Capitanini, *Medical Devices Vulnerable to Hack Attacks*, NBC Chi. (Sept. 29, 2014), URL *supra* p. vii; Javier E. David, *Shhh, Not in Front of the TV! Samsung May Be Eavesdropping on You*, CNBC (Feb. 8, 2015), URL *supra* p. vi; Karl Russell et al., *How Volkswagen Is Grappling with Its Diesel Deception*, N.Y. Times (Mar. 24, 2016), URL *supra* p. viii; Brian Ross et al., *Toyota to Pay $1.2B for Hiding Deadly "Unintended Acceleration"*, ABC News (Mar. 19, 2014), URL *supra* p. viii.

hardware competing with the seller's own peripherals, or privacy-protecting software.[14] Others disallow modifying software on the device, even in ways that infringe no intellectual property right, thereby preventing efforts to make the device accessible to people of differing capabilities or interoperable with other systems.[15]

Modifications to personal property serve important and even critical purposes for consumers. These include patching security vulnerabilities, blocking invasive collection of personal data, installing new software, or attaching new hardware (such as sensors, additional memory, or more durable components). These practices are lawful by virtue of exhaustion and related doctrines, such as copyright law's fair use and rights recognized by 17 U.S.C. § 117 (adaptation of computer programs) and § 1201(f)–(j) (exemptions to ban on circumvention).

While the word "consumers" ordinarily references natural persons, the consumers who rely on purchased products for innovation include technology startups, small businesses, and even large companies, all of whom often must purchase existing products in order to improve upon them. Developers of self-driving cars, for example, are primarily software companies who build their innovations on vehicles purchased as any other consumer would—terms of use and all.[16] Cloud computing ser-

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[14] *See* Cory Doctorow, *Windows 10 EULA: Microsoft Can Kill-switch Your Unauthorized Hardware and Pirate Games*, Boing Boing (Aug. 20, 2015), URL *supra* p. vi; *Protecting Your Privacy: App Ops, Privacy Guard, and XPrivacy*, xda-developers (June 11, 2014), URL *supra* p. viii.

[15] *See* Pet. Amicus Br., *supra*, at 5a, 6a.

[16] *See* Damon Lavrinc, *Exclusive: Google Expands Its Autonomous Fleet With Hybrid Lexus RX450h*, Wired (Apr. 16, 2012), URL *supra* p. vii.

vices, the infrastructure for today's information economy, depend on purchases of numerous discrete components, both hardware and software, subjecting the providers of those services potentially to a multitude of restrictions, conditions, and limitations that could act to prohibit such services *ab initio*.[17]

This Court previously recognized "the danger of allowing [] an end-run around exhaustion" to technology companies who assemble systems out of multiple components. *Quanta*, 553 U.S. at 630. That danger is no less applicable here.

Product manufacturers and sellers have strong profit motives to seek to impose these anti-consumer conditions on product buyers' lawful activities—indeed, one manufacturer implemented a system that would immediately disable a product until the owner agreed to *new* terms of service that the manufacturer desired.[18] Yet consumers still retain strong rights of autonomy, in no small part because the common law and the exhaustion doctrine strongly disfavor post-sale restraints on property.

It would be inconsistent with ideals of free speech and the intellectual property goals of promoting innovation, if sellers had the unbridled power to impose the sorts of controls described above. It would also be inconsistent with people's autonomy to audit and control their personal property to make it serve them rather than acting as a continuing agent for the seller after sale.

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[17] *See, e.g.*, Andrew Cunningham, *Life After Death for Apple's Xserve*, Ars Technica (Oct. 9, 2016), URL *supra* p. v (describing effect of hardware manufacturer's restrictive practices on cloud computing services).

[18] *See* Kit Walsh, *Nintendo Updates Take Wii U Hostage Until You "Agree" to New Legal Terms*, Electronic Frontier Found. (Oct. 13, 2014), URL *supra* p. ix.

Manufacturers may use contracts to bind consumers with whom they have privity, up to the ordinary limits of contract law—but no further, *see, e.g.*, *Phila. Indem. Ins. Co. v. Barerra*, 21 P.3d 395, 402 (Ariz. 2001) (unconscionability and reasonable expectation doctrines); *Perricone v. Perricone*, 972 A.2d 666, 682–83 (Conn. 2009) (public policy limits in contractual waiver of speech rights). In addition to the limitations on formation and enforcement of contracts, contractual obligations do not run with the property and do not bind successive owners. Contract law thus includes fail-safe mechanisms to avoid the competition and consumer harms presented by an unshakable post-sale condition tied to the physical article.

The law should not grant patent-owning sellers a vehicle for unilaterally overriding the rights of purchasers. The judgment of the Federal Circuit should be reversed.

B. Limitations on Resale and Repair Rights Lead to Monopolization Rather Than Competition

Patent exhaustion, like the common law, advances full ownership rights for consumers. Those ownership rights reduce information costs and simplify transactions, making such rights the wellspring of market competition. Absent the exhaustion doctrine, then, sellers of products may seek to undercut competition and monopolize markets to the detriment of consumers and the public.

1. The Federal Circuit's exceptions to patent exhaustion greatly weaken competition in secondary markets.

Secondary markets are a core component of the consumer economy. Companies like eBay and Craigslist give consumers access to highly efficient secondary markets for an unprecedented variety of goods. Other secondary

markets are supported by intermediaries ranging from specialized resellers and refurbishers, to general secondhand stores such as Goodwill.[19] One consultancy predicted the secondary market in smartphones alone to be worth $17 billion in 2016.[20]

Secondary markets offer numerous social and economic benefits to consumers, such as placing lower-cost used goods on the market, allowing purchasers to recoup some of their purchase cost at market rates, and protecting the environment by enabling reuse and recycling. *See* Chafee, *supra*, at 1261 (describing "policy in favor of mobility" long embraced by personal property law).

Manufacturers seek to control their products and profits by cutting off these secondary markets. Besides Lexmark's single-use restriction at issue in this case, companies regularly sell products with terms of service that do not allow the buyer to "transfer, assign, or sublicense its license rights to any other person or entity."[21]

The two exceptions to exhaustion allow manufacturers to circumvent the traditional rules against restraints on alienability, helping them gain this monopolistic and anti-consumer power. Since the most basic consumer products may be patented, exceptions to patent exhaustion will increasingly undercut secondary markets.[22]

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[19] *See* Kyle Wiens, *One Way to Create American Jobs: Fix Our 5 Million Tons of Out-of-Use Electronics*, The Atlantic (Oct. 31, 2012), URL *supra* p. ix.

[20] Paul Lee et al., Deloitte, *Technology, Media & Telecommunications Predictions 2016*, at 50 (2016), URL *supra* p. vii.

[21] Pet. Amicus Br., *supra*, at 4a; *see also* John Villasenor, *What the Restrictions on Resale of Google Glass Mean for Consumers*, Slate (Apr. 23, 2013), URL *supra* p. ix.

[22] Patents may cover even the most ordinary and old consumer products today. Products now often contain embedded software, en-

2. Exceptions to exhaustion also threaten competition within the repair market. This Court's precedents have long distinguished repair from reconstruction, making it clear that repair activities short of reconstruction fall outside the scope of the patent. *See Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U.S. 336, 342–43 (1961). The Federal Circuit's holdings on exhaustion jeopardize independent product refurbishers and repair services, insofar as multi-use prohibitions on re-use or repair could be brought home against such services by patent infringement actions.

A thriving independent repair market is beneficial. As anyone who has ever sought automotive repair services is well aware, consumers are better off with a wide array of competing providers of post-sale service and repair. One study suggested that consumers can cut their car repair bills by an average of about $300 a year, or 25%, by going independent.[23] The repair industry also supports local employment and helps reduce waste.[24]

The secondary sale and repair markets can have substantial impacts on a range of industries, including healthcare. In the case of the medical device reprocessing industry, for example, the Government Accountability Office

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tangling those products with the large number of software patents in force. *See* Dep't of Commerce Internet Policy Task Force, *Fostering the Advancement of the Internet of Things* 37 (2017), URL *supra* p. vi. Also, those products may be covered by a design patent, even one directed to just "a component of a multicomponent product." *Samsung Elecs. Co. v. Apple Inc.*, 137 S. Ct. 429, 435 (2016).

[23] *See* Jonathan Welsh, *Is the Dealer Better Than an Independent Mechanic?*, Wall St. J. (May 17, 2010), URL *supra* p. ix.

[24] *See* Jenna Wortham, *How to Fix Your iPhone (the Unofficial Edition)*, N.Y. Times, Apr. 14, 2010, at B9, *available at* URL *supra* p. x; Victor Luckerson, *We've Spent Almost $6 Billion on iPhone Repairs Since 2007*, Time (Sept. 20, 2012), URL *supra* p. vii.

reported that hospitals saved $200,000 to $1 million annually by using certain reprocessed medical equipment; another report estimated that hospitals produced between 5,000 and 15,000 fewer pounds of waste.[25]

3. Exceptions to patent exhaustion also encourage sellers themselves to engage in economically inefficient behavior in order to obtain future control over their products. For example, following the decision in *Quality King Distributors Inc., v. L'anza Research International Inc.* that copyright in a shampoo bottle label will not permit the shampoo vendor to block importation of the product into the United States, *see* 523 U.S. 135, 145 (1998), the vendor may seek design patents on the label to regain that power to block importation, foisting upon the public further patents sought simply for the purpose of frustrating competition. Sellers may also use exceptions to exhaustion to implement schemes of market segmentation and price discrimination.[26] That practice contravenes basic free-market economics to the point that it

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[25] *See* U.S. Gen. Accounting Office, *No. GAO/HEHS-00-123, Single-Use Medical Devices: Little Available Evidence of Harm from Reuse, but Oversight Warranted* 19 (2000), *available at* URL *supra* p. ix; U.S. Int'l Trade Comm'n, *Inv. No. 332-525, Remanufactured Goods: An Overview of the U.S. and Global Industries, Markets, and Trade* D–3 (2012), *available at* URL *supra* p. ix (statement of Association of Medical Device Reprocessors).

[26] For example, field-of-use restrictions, which the conditional sale doctrine enables, are used to prevent arbitrage and thus implement price discrimination among classes of consumers. *See* Mark R. Patterson, *Contractual Expansion of the Scope of Patent Infringement Through Field-of-Use Licensing*, 49 Wm. & Mary L. Rev. 157, 159–60 (2007). Certainly patents provide a limited power to price-discriminate, but that power is not unlimited; the grant of patent monopolies to inventors "was never designed for their exclusive profit or advantage." *Kendall v. Winsor*, 62 U.S. (21 How.) 322, 328 (1859).

has sometimes been deemed an antitrust violation. *See* Robinson-Patman Price Discrimination Act, 15 U.S.C. § 13 (2012); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 219–20 (1993).

Patent exhaustion prevents product manufacturers from engaging in this extensive menu of inefficient, anti-consumer strategies. The Federal Circuit's exceptions to exhaustion enable and indeed encourage these very strategies. Those exceptions should be removed.

III. Purported Justifications for Weakening Exhaustion Are Overstated and Do Not Overcome These Consumer Harms

Patent owner Lexmark and several supportive *amici* have suggested that weakening the patent exhaustion doctrine is desirable as a matter of public policy. These contentions are unsupportable and in any event do not outweigh the strong and age-old policy favoring protection of consumers' personal property ownership rights.

A. Public Policy Matters Such as Drug Pricing Are for the Political Process, Not the Whims of Patent Owners

Several *amici* contended that exceptions to patent exhaustion will enable novel market pricing structures that are preferable as a matter of public policy. Most notably, the pharmaceutical industry contends that international non-exhaustion allows drug manufacturers to charge developed nations higher prices for drugs, thereby lowering prices in developing nations without fear of developed nations reimporting those cheaper medicines. But this and similar arguments do not justify a weakening of patent exhaustion, because the proffered policy benefits ought

to be implemented through the political process, not by the unilateral choice of patent owners.

At the outset, the oddity of this pharmaceutical argument must be noted. United States policy does not ordinarily prefer situations that cost the United States more money, and yet industry here is championing a practice that, by definition, costs American consumers more. Already for American consumers the cost of medicine is skyrocketing: one study estimates the retail cost of drug therapy for an average older American using 4.5 prescription drugs at $26,132 per year, an amount that exceeds the median Medicare beneficiary's annual income by almost $2000.[27] And the benevolence of this industry argument must be questioned: At least some evidence suggests that national drug price differentials do not actually make medicines accessible to the poor, but rather raise prices to extract as much profit as possible from the elites in each nation.[28]

But however desirable or not it may be to engage in this sort of price-differential scheme in the pharmaceutical or other market, patent law is not the way to achieve that result. Rather, it should be up to Congress to restrict importation of drugs. Congress undoubtedly has the power to do so and indeed already has legislated on reimportation of foreign-sold medicines.[29] The powerful

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[27] *See* Stephen W. Schondelmeyer & Leigh Purvis, AARP Pub. Policy Inst., *Trends in Retail Prices of Brand Name Prescription Drugs Widely Used by Older Americans, 2006 to 2015*, at 18 (2016), *available at* URL *supra* p. viii.

[28] *See* Sean Flynn et al., *An Economic Justification for Open Access to Essential Medicine Patents in Developing Countries*, 37 J.L. Med. & Ethics 184 (2009).

[29] *See* 21 U.S.C. § 381(d)(1); Michele L. Creech, Comment, *Make a Run for the Border: Why the United States Government Is Looking*

pharmaceutical lobby does not need this Court's help to obtain the policies it desires.

Rewriting general patent exhaustion law to achieve this highly specific goal is misguided for two reasons. First, it places a difficult public policy question not in the hands of elected representatives but rather in the control of self-interested patent owners. Drug pricing is a contentious topic today, with pharmaceutical manufacturers being heavily criticized for excessively high prices.[30] Using patent exhaustion to implement drug price differentials among nations gives those manufacturers sole control over the pricing scheme, where the better course would be to leave the matter to the legislature.

Second, the rule of patent exhaustion affects all industries, not just pharmaceutical manufacturers. Car manufacturers, consumer electronics makers, sellers of household items, and all sorts of other vendors of commodities would be enabled to engage in all of the anti-consumer behavior described in this brief that the exhaustion doctrine would otherwise prohibit. Twisting the exhaustion doctrine to serve just one or two idiosyncratic industries, then, would be to prescribe a narcotic where all that is needed is an ibuprofen.

Weakening exhaustion is not the proper way to achieve specific policy goals like enabling access to medicines. Instead, it is patent exhaustion that effectuates a most important policy goal, the protection of consumer property rights.

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to the International Market for Affordable Prescription Drugs, 15 Emory Int'l L. Rev. 593 (2001).

[30] *See, e.g.*, Sarah Jane Tribble & Sydney Lupkin, *High Prices for Orphan Drugs Strain Families and Insurers*, NPR (Jan. 17, 2017), URL *supra* p. viii.

B. Patent Owners Do Not Have the Right to Exploit and Subdivide Their Patent Rights However They Please

Lacking an actionable public policy reason for constricting exhaustion, Lexmark and supporting *amici* are left arguing that it is simply the prerogative of the patent owner to subdivide the intellectual property right in whatever way the owner pleases, and conditional sales and other exceptions to exhaustion are part of that subdividing. Indeed, this is the heart of Lexmark's prebate arrangement, which in the guise of offering "consumer choice" essentially is a company's effort to partition its patent rights in a novel and arbitrary way.

Yet the common law already addresses whether this arbitrary partitioning may be done. The answer is no.

Ownership of land and chattels, of course, is also a bundle of rights like patents, but the common law does not permit those bundles to be partitioned in any way desired. Professor Chafee notes the ancient principle that "forbade a grantor to create novel estates in land," Chafee, *supra*, at 1258, and innumerable cases support this notion that the list of fee estates and other property rights is limited and closed. *See, e.g.*, *Keppell*, 39 Eng. Rep. at 1049; *Whiton*, 34 N.E. at 542; Oliver Wendell Holmes, *The Common Law* 407 (1881) (noting "rule that new and unusual burdens cannot be imposed on land").

Property rights cannot be subdivided in novel ways for the same reason that post-sale restraints on property are disfavored: to protect consumers from "unacceptable information costs" resulting from unexpected and complex ownership structures. Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The* Numerus Clausus *Principle*, 110 Yale L.J. 1, 26

(2000). And how much more true is this when the property being subdivided is the more limited class of intellectual property rights, while the information costs imposed by that subdivision burden far more fundamental rights in personal, physical, tangible property. *See* Perzanowski & Schultz, *supra*, at 23–24.

Just two Terms ago, this Court rejected a patent owner's bid to relax a rule that restricted the patent owner's ability to engage in novel licensing arrangements under the patent. *See Kimble v. Marvel Entm't, LLC*, 135 S. Ct. 2401, 2415 (2015). The Court found the competing economic analyses inconclusive, and thus applied *stare decisis* to defer to Congress's "prerogative" to choose the policy "that will optimally serve the public interest." *Id.* at 2414. *Stare decisis* in the present case is sufficient to reverse the Federal Circuit and reaffirm the unbroken chain of this Court's decisions holding that exhaustion is an unqualified doctrine that admits no circumventions.

But the case for exhaustion is stronger, for the policy and economic analysis is conclusive: Seven hundred and twenty-seven years of law, from the *Quia Emptores* to now, hold as paramount the policy of protecting owners' rights to enjoy, use, and alienate personal property. No less than a sound rejection of patent owners' attempts to carve holes into the doctrine of patent exhaustion will uphold this consumer protection policy, a policy old as the hills and yet of pressing importance today.

CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals should be reversed.

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